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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM 1998

In Re: FRED SANDERS, INC.,
Debtor.

SALEK E. BEIM, et al.
Petitioners,

v.

JAY ALIX, Trustee,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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79 pp

QUESTIONS PRESENTED FOR REVIEW

The lack of definite and objective standards for the determination of *fair valuation* of assets and, therefore, insolvency in preference actions and fraudulent conveyance actions under 11 USC 547 and 548 of the bankruptcy code results in arbitrary findings of "insolvency". This also results in unintended and unfair treatment of transferees such as the Defendants in the instant case.

LIST OF PARTIES

Petitioners

Salek E. Beim; Morton Wertheimer; Yesod Internatinal, Inc.; Filipp Kreissl; John M. Sanders; Sanders Confectionery Products, Inc.

Respondent

Jay Alix, Trustee

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OPINIONS BELOW

The opinion of the United States Court of Appeals 6th/ Circuit in Beim et al vs. Jay Alix, Trustee is included below as Appendix A.

JURISDICTION

The judgment of the United States Court of Appeals was rendered November 9, 1998 and an extension was granted for the filing of this Petition for Writ of Certiorari. The jurisdiction of this Court is invoked under the provisions of 28 USC 1254(1).

STATEMENT OF THE CASE

The Debtor, Fred Sanders Inc. (FSI) was a 115-year-old confectionery institution in Detroit, Michigan.[1] In 1986-7 the two principals of FSI, John M. Sanders and Filipp Kreissl, developed a plan of investment in the business, which involved a public offering to raise the necessary capital.

In order to accomplish this, the two principals of FSI sought to acquire a public corporation and conduct a public offering.[2] In order to fund the acquisition of the public corporation and pay for the expenses of a public offering, it

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1 A confectionery business manufactures candy, cakes, fudge topping and other sweets. Sanders was a high profile area business with a great deal of public sentimentality attached to it, which contributed to the success of the public offering.

2 It was financially expedient to purchase a public corporation rather than go through the lengthy and costly process of forming a public company in Michigan.

was necessary to secure "bridge" financing. The Defendants, Salek Beim and Morton Wertheimer of Morristown, New Jersey and their associates, provided the necessary funds in the form of loans, some of which required the personal guarantees by Kreissl and Sanders.[3]

A public corporation was acquired and re-named "Sanders Confectionery Products, Inc" (SCPI). SCPI conducted a public offering from December 1986 to April 1987, and it raised $4,587,627, which it downstreamed to Fred Sanders Inc. (FSI) with the only condition being that FSI was directed as an accommodation to pay the New Jersey lenders for the "bridge" funding since SCPI did not maintain a separate checking account.

Ninety percent (90%) of the payments at issue here were made between the end of the audit period, December 27, 1986, and the conclusion of the public offering in April 1987. Neither FSI nor the transferees had any reason to anticipate a bankruptcy when these payments were made.

Heller Financial Inc., FSI's commercial funder, having been acquired by a Japanese bank, decided to eliminate all of their small asset based loans. In the Debtor's case, FSI was forced without notice, upon the demand of Heller Financial, to file a Chapter 11 bankruptcy petition on November 16, 1987. As a direct result, the assets of FSI were liquidated in May 1988, one year after the New Jersey payments were made.

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[3] The Defendants are not arguing the issues relating to 11 USC 550 nor those relating to "insider" under 11 USC 547 in this initial petition but preserve the issues for subsequent arguments.

The Bankruptcy Court based its determination of insolvency at the time of the transfers, 90% of which were concluded by April 1987, upon the financial condition of the Debtor in May 1988, rather than the financial condition at the time of the transfers.[4]

REASON FOR GRANTING THE WRIT

11 USC 101(32) defines "insolvency" as a condition that exists when the total sum of the debts exceeds the value of all the property determined at *fair valuation*.

The Defendants believe that this case is of interest to the national jurisprudence because while the bankruptcy code requires "insolvency" to be shown on the actual date of the transfers, there is no statutory or case law that defines *fair valuation* which is an integral part of the insolvency formula.

The lack of precision in defining *fair valuation* leaves the determination of *fair valuation* and subsequently "insolvency" to the discretion of the bankruptcy court. This causes uncertainty and diverse opinions on the subject. Here, it led to reversible error and considerable unfairness to the Defendants who provided the necessary "bridge" funding, received repayments in good faith and with the knowledge that the Debtor had just benefited from a highly successful public offering.

In reviewing all the U.S. Supreme Court bankruptcy decisions over the last 50 years there have been no decisions

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[4] Both 11 USC 547 and 548 require that the determination of insolvency be based on the financial condition of the debtor literally on the calendar date the transfers were made.

dealing with what is meant by *fair valuation*. Lacking a review of this issue, debtors and transferees will continue to be exposed to the possibility of unintended and unfair treatment.

ARGUMENT

Both 11 USC 547 and 548 require a finding of "insolvency" on the date any transfers were made before permitting the recovery of the payments made to creditors prior to filing a bankruptcy. Conversely, the trustee can not recover transfers made while the debtor was solvent.

The facts in this case show that ninety percent (90%) of the transfers were made just after the Debtor, FSI, received approximately $4,584,627 as paid in capital from a successful public offering by its parent Sanders Confectionery Products, Inc. (SCPI). FSI made the payments in good faith and neither the transferees nor FSI had any knowledge of the impending action by Heller Financial, which caused the unexpected filing of a Chapter 11 bankruptcy in November 1987.

The actual financial condition of FSI at the time of the transfers is based in part upon the certified audit by Deloitte, Haskins and Sells for the year ending December 27, 1986 and then a successful public offering showing a positive net worth of approximately $2,500,000 before and during the period of the transfers.

It is impossible to reconcile the Bankruptcy Court's finding that "the Debtor was insolvent at the time of all transfers " with these facts. (Shapero opinion, pg. 23)

"Insolvent" means that the sum of an entity's debts is greater than all of such entity's property at *fair valuation*. 11

USC §101(32)(A). The annotations to the Bankruptcy Code describe the definition as the "traditional bankruptcy balance sheet test of solvency."

The problem with this, even though it's described as the balance sheet test of solvency, is that there are still no clear methods of describing *fair valuation* because there is still uncertainty in applying the three traditional methods of valuation: (1) fair market value (2) going concern value and (3) liquidating value. Each of these will produce dramatically different result. There is no standard valuation formula that is used to determine *fair valuation.*

In this case, the Bankruptcy Court improperly considered the financial condition of the Debtor at the time of the liquidating sale in May 1988, one year later and applied near liquidation values to certain assets to find insolvency and relate it back to the time of the transfers. This is contrary with both the Code and case law. See In Re Nathanson Bros., 64 F2d 912, 913 (6th Cir 1933); In Re Ballanca Aircraft Corp., 56 BR 339, 387 (Bankr. D. Minn 1985)

These facts, including the unexpected and forced bankruptcy point to the unreliability of the liquidating sale as a material "subsequent event". Its use by the Court was clear error resulting from the lack of standards to determine *fair valuation.*

All Circuits have decisions reciting the insolvency formula but do not give any guidelines or mandates as to what standards for valuation are to be used in determining *fair valuation.* It is this lack of standards that creates an issue of importance to the national jurisprudence. Even with the new bankruptcy code pending, the issue of solvency is still not resolved.

Respectfully submitted,

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APPENDIX A

NOT RECOMMENDED FOR FULL TEXT PUBLICATION

UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

No. 97-2218

FILED
November 9, 1998
LEONARD GREEN, Clerk

IN RE: SANDERS
Debtor.
_____/

SALEK E. BEIM; MORTON J. WERTHEIMER; YESOD, INTERNATIONAL, INC.; FILIPP KREISSL; JOHN M. SANDERS; SANDERS CONFECTIONARY PRODUCTS, INC., Appellants,	) On Appeal From The United States District Court For The Eastern District of Michigan
v.	
JAY ALIX, Trustee, Appellee.	

_____/

Before MERRITT, COLE, and FARRIS[1], Circuit Judges.

MERRITT, Circuit Judge. This appeal arises from the district court's finding that $211,000 of transfers made by Fred Sanders, Inc. ("Debtor") to the defendants are voidable.

Prior to 1986, Defendants-Appellants Sanders and Kreissl had become the controlling shareholders of Debtor and concluded that a public offering was necessary to provide Debtor with needed capital. Each of them obtained a personal loan from Appellant Wertheimer for $65,000 on July 17, 1986 ("Loan 1"). They signed promissory notes memorializing the repayment terms of Loan I and obligating themselves to pay back the $130,000 total within 181 days from the date signed.

Sanders and Kreissl used the proceeds to fund the purchase of stock in their name, in Tamarac, a publicly traded company. Thereafter, Sanders and Kreissl along with other shareholders of Debtor, exchanged their shares in Debtor for shares of Tamarac. Thus, Sanders, Kreissl and the other shareholders became owners of the controlling interest in the shares of Tamarac and Tamarac owned all shares of the Debtor. In 1986, Tamarac was renamed Sanders Confectionery Products, Inc. ("Sanders Confectionery").

Shortly after the formation of Sanders Confectionery, the company embarked on a public offering of about one-third

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[1] The Honorable Jerome Farris, Senior Judge, United States Court of Appeals for the Ninth Circuit, sitting by designation.

of its stock in order to obtain the needed operating capital for the Debtor. However, the proceeds of that public offering were required to be held in escrow until certain conditions were met. The Debtor needed capital in the meantime.

In an effort to secure interim capital, Defendant Beim arranged for various investors, including Defendant Wertheimer to loan a total of $300,000 ("Loan II") to Sanders Confectionery, the corporate parent of Debtor. This loan was made on or about January 22, 1987, and the money obtained by Sanders Confectionery was given to and used by the Debtor.

About one month after obtaining Loan II, $4.3 million in net proceeds from the public offering were released to Sanders Confectionery which immediately transferred the funds to the Debtor as a capital contribution. The money was used by Debtor to pay various overdue tax obligations as well as the following transfers at issue in this litigation:

(1) On January 21, 1987, Debtor paid a roll-over fee of $7,500 to Defendant Beim for $130,000 in personal loans of Defendants Sanders and Kreissl (Loan I).

(2) On April 16, 1987, Debtor paid the entire $130,000 principal of the personal loan of Defendants Sanders and Kreissl (Loan I).

(3) On January 27, 1987, Debtor paid Defendant Beim $18,000 in finder's fees in exchange for the 4300,000 loan (Loan II) to Sanders Confectionery.

(4) Thereafter, Debtor paid $56,000 in interest and extension fees on Loan II to Defendants Beim, Wertheimer, and Yesod.

Debtor filed bankruptcy on November 16, 1987. On November 30, 1989, Trustee Jay Alix instituted proceedings to recover the transfers made with respect to Loans I and II on the theory that the transfers were fraudulent conveyances, or in the alternative, voidable preferences.

The bankruptcy court held that the Debtor's transfers with respect to Loan I were voidable as fraudulent conveyances under 11 U.S.C. § 548 ("§ 548") because it found that Debtor did not receive reasonably equivalent value and because Debtor was insolvent on the date of the transfers. The bankruptcy court also held that transfers related to both loans were voidable preferences under 11 U.S.C. § 547 ("§ 547") because it found that the transfers were made to creditors on account of antecedent debts within the statutory period and gave the creditors more than they would have received in a bankruptcy proceeding.

In assessing damages, the bankruptcy court limited recovery to those defendants who were immediate recipients of the transfers and declined to order recovery from other beneficiaries of the transfers.

The district court affirmed the bankruptcy court with respect to the voidability of the transfers and overruled the bankruptcy court's decision to limit recovery to the immediate transferees of assets.

1. THE FRAUDULENT TRANSFERS

The bankruptcy court and the district court both determined that the Trustee established that the transfers with respect to Loan I were avoidable under § 548, which provides in relevant part:

> (a) The trustee may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition, if the debtor voluntarily or involuntarily —
>
> . . .
>
> (2)(A) received less than a reasonably equivalent value in exchange for such transfer or obligation; and
>
> (B)(i) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;
>
> (ii) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital . . . .

The district court specifically found that the transfers were made without the Debtor receiving reasonably equivalent value, within one year of the petition date, and while Debtor was insolvent.

Defendants make three arguments for reversal of the district court's conclusion that the Loan I transfers were fraudulent conveyances. First, they assert that the transfers did not involve property of the Debtor as required by § 548. They claim that the Debtor was a mere conduit for the funds of Sanders Confectionery and thus the earmark doctrine should be applied.

The earmark doctrine applies where: (1) the assets in question were never under the control of the debtor; (2) the assets are transferred from a third party to the creditor as a payment for an antecedent debt owed by the debtor; and (3) the debtor's estate is not diminished in value. *In re McLean Industries, Inc., v. United States*, 162 B.R. 410, 420 (S.D.N.Y. 1993), *reversed on other grounds*, 30 F.3d 385 (2d Cir. 1994).

The earmark doctrine does not apply in this case. Contrary to defendants' assertion, the transfers involved the property of the Debtor. The money raised from the public offering of Sanders Confectionery was contributed as capital to the Debtor. hence, in repaying the loan, the Debtor was paying out its own money. Furthermore, Defendant Sanders testified that the proceeds from the offering of Sanders Confectionery were invested in Debtor and were not a loan.

Moreover, Loan I was not a loan to Sanders Confectionery but a personal loan to shareholders of the Debtor. Thus, defendants assertion that Debtor was acting as a conduit to pay the loans of Sanders Confectionery cannot be true. Sanders Confectionery was not liable on Loan I.

The defendants also contend that Debtor was solvent

when the transfers were made, negating a statutory requirement of § 548. Both the bankruptcy and district courts disagreed. An insolvency determination is reviewed for clear error. *In re Tennessee Chemical Company v. Shell Canada*,. 112 F.3d 234, 236 (6th Cir. 1997). The district court did not commit clear error. Defendants' financial expert testified about the insolvency of the Debtor on April 18, 1997, only. He did not give an opinion on insolvency on the various other dates of the transfers in question which occurred months apart from April 1987. There is no rebuttal of the testimony of the Trustee's expert on insolvency on any date other than April 18, 1997.

Furthermore, defendants' expert based his valuations on a purported balance sheet dated April 17, 1987. This document was not admitted into evidence because defendants produced no evidence as to who prepared it or when it was prepared.

Defendants' expert based his valuation of Debtor's real estate on a certain appraisal. However, that appraisal stated:

> Certain conclusions contained in this report were derived from projections and other economic data provided by the client and are subject to adjustment in the event that such projections or other data prove to be inaccurate or unrealistic.

The client was the Debtor itself and the projections were wildly sanguine economic forecasts that later proved to be wrong. Given this, the district court's conclusion that the Debtor was insolvent cannot be clear error.

2. THE PREFERENTIAL TRANSFERS

The Trustee asserts that the transfers involving Loan II were preferential transfers avoidable under § 547, which provides in relevant part:

> (b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property --
>
> (1) to or for the benefit of a creditor;
>
> (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
>
> (3) made while the debtor was insolvent;
>
> (4) made —
> (A) on or within 90 days before the date of filing of the petition; or
>
> (B) between 90 days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
>
> (5) that enables such creditor to receive more than such creditor would receive if —
>
> (A) the case were a case under chapter 7 of this title;

> (B) the transfer had not been made; and
>
> (C) such creditor received payment of such debt to the extent provided by the provisions of this title.

Defendants contend that the district court erred in finding that the Loan II transfers were voidable preferences because the Trustee did not prove that Beim and Wertheimer were either creditors or insiders of the Debtor as required by § 547.

Beim and Wertheimer were certainly creditors of the Debtor. They admit as much. In response to the fraudulent conveyance claim, the defendants asserted that the Debtor made the transfers to them on account of its own debts and not those of others.

The conclusion that Beim and Wertheimer were creditors of the Debtor is also amply supported by the record. The proceeds of Loan II were borrowed by Sanders Confectionery but they were paid over and used by the Debtor. Debtor paid the finders fee to obtain the loan, and paid all extension fees and interest on the loan. A creditor is defined broadly as an entity that has a claim against the debtor that arose at the time or before the order for relief concerning the debtor. Claim is also defined broadly as a right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured. *See, In re Cartage Co., Inc.*, 899 F.2d 1490, 1492 (6th Cir. 1990).

Defendants further argue that it was error to allow recovery against Beim and Wertheimer because the bankruptcy court did not determine that they were insiders. It is not necessary to determine that Beim and Wertheimer were insiders in order to recover payments against them when the payments made benefitted insider creditors or guarantors. This is precisely the doctrine articulated by this court in *In re Cartage Co., Inc.*, 899 F.2d at 1493-95.

Sanders and Kreissl were at all relevant times officers and directors of the Debtor, and Sanders Confectionery was the sole shareholder of Debtor. There is no question that these parties are insiders under the bankruptcy code. At trial it was admitted that Sanders and Kreissl guaranteed Loan II. Moreover, Sanders Confectionery was obligated to pay Loan II. Hence, insiders Sanders, Kreissl, and Sanders Confectionery, all benefitted from the Loan II transfers. This allows recovery to be imposed against Beim and Wertheimer regardless of whether they are insiders.

Defendants contest none of the other elements of § 547.

3. THE § 550 CLAIM

The bankruptcy court limited recovery to defendants Beim, Wertheimer and Yesod. The district court overruled and imposted liability upon all defendants. A trustee is permitted to recover from "the initial transferee of such transfer or the entity for whose benefit the transfer was made; or any immediate or mediate transferee. . ." 11 U.S.C. § 550 ("§ 550"). As stated in the immediately previous discussion of § 547, Sanders, Kreissl and Sanders Confectionery

benefitted from the transfers. Thus, recovery against them is explicitly authorized by § 550. The bankruptcy court denied recovery against them because it felt such recovery would be "inappropriate." As the district court correctly pointed out, the bankruptcy court forgot the holding of *In re Cartage Co., Inc.*, 899 F.2d at 1494 that bankruptcy courts may not use equitable powers to disregard unambiguous statutory language. hence, the district court did not err in granting recovery against defendants Sanders, Kreissl, and Sanders Confectionery.

4. CONCLUSION

For the reasons stated above, the district court is AFFIRMED.

APPENDIX B

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

FILED
October 27, 1997

IN THE MATTER OF: FRED SANDERS, INC., Debtor. _____/	Case No. 87-06979 Chapter 11 Hon. Walter Shapero
JAY ALIX, Trustee, Plaintiff/ Appellee/ Cross-Appellant,	Adversary Proceeding No. 89-0876
v.	U.S. District Court Nos 97-71736 97-72020 Hon. Horace Gilmore

SALEK E. BEIM, YESOD INTERNATIONAL, INC., FILIPP J. KREISSL, JOHN M. SANDERS, MORTON J. WERTHEIMER, THOMAS F. DESENA, SR., JOSEPH P. GORYEB, ALLAN J. SCHER, GERALD C. SELKE, CHARLOTTE GERBER TURNER, CARMEN GALDIERI, SCHENK, PRICE, SMITH & KING, SANDERS CONFECTIONERY PRODUCTS, INC., JEFFREY BAYDIN, and LYNDA BAYDIN,
Defendants/ Appellants/
Cross-Appellees.
_____/

MEMORANDUM OPINION AND ORDER

Horace W. Gilmore

October 20, 1997

I. SUMMARY

Both parties in the present matter appeal from the decision of Bankruptcy Court. The Bankruptcy Court found that transfers made to certain Defendants by the Debtor were voidable and ordered judgment against those Defendants. Appellants contend that the Bankruptcy Court erred in finding that the transfers were voidable. Appellees contend that the Bankruptcy Court erred in limiting recovery to the immediate transferees of the assets, rather than ordering judgment against other defendants who were insider beneficiaries of the transfers as well. The issues have been briefed extensively, and the Court heard argument on October 9, 1997. Based on the following, the Court AFFIRMS the Bankruptcy Court with respect to the voidability of the transfers and OVERRULES the Bankruptcy Court's decision to limit recovery to the immediate transferees of assets.

II. FACTS

Prior to 1986, Appellants Sanders and Kreissl had become the controlling shareholders of Fred Sanders, Inc. ("Debtor") and concluded that a public offering was necessary to provide Debtor with needed capital. Each of them obtained a personal loan from Appellant Wertheimer for $65,000, for $130.000 total, on July 17, 1986 ("Loan I"). They signed promissory notes memorializing the repayment terms of Loan

I and obligating themselves to pay back the $130,000 within 181 days from the date signed.

After obtaining the $130,000, Appellants Sanders and Kreissl used the proceeds to fund the purchase of stock, in their own names, in a publicly traded company known as Tamarac. Thereafter Appellants Sanders and Kreissl, along with other shareholders of Debtor, exchanged their shares in Debtor for shares of Tamarac. As a result, Appellants Sanders and Kreissl and the others became owners of all of. or the controlling interest in, the stock of Tamarac, and Tamarac then owned the shares of Debtor. Upon acquiring a controlling interest in Tamarac in the fall of 1986, Tamarac was renamed Sanders Confectionery Products, Inc. ("SCPI"), and SCPI became the corporate parent of Debtor. Thus, Appellants Sanders and Kreissl and Debtor's former shareholders became SCPI's primary and controlling shareholders.

Shortly after the formation of SCPI, the company embarked on a public offering of about one-third its stock in order to obtain the needed operating capital for Debtor. However, the proceeds of that public offering were required to be held in escrow until certain conditions were met, and Debtor needed capital in the meantime. In an effort to secure capital for Debtor, Appellant Beim arranged for various investors, including Wertheimer, to loan a total of $300,000 to SCPI, the parent corporation of Debtor (Loan II). Loan II was made on or about January 22, 1987, and the money obtained by SCPI was apparently given to and used by Debtor.

About one month after obtaining Loan II, $4.3 million

in net proceeds from the public offering were released to SCPI. SCPI immediately transferred the funds to Debtor as a capital contribution. The money was used by Debtor to pay various overdue tax obligations as well as the following transfers at issue here:

1) On January 21, 1987, Debtor paid a roll-over fee of $7,500 to Defendant Beim for the $130,000 in personal loans of Defendants Sanders and Kreissl (Loan I).

2) On April 16, 1987, Debtor paid the entire $130,000 principal of the personal loans of Defendants Sanders and Kreissl (Loan I).

3) On January 27, 1987, Debtor paid Defendant Beim $18,000 in finder's fees in exchange for the $300,000 loan (Loan II) to SCPI, which was then transferred to Debtor.

4) Thereafter, Debtor paid interest and extension fees on Loan II totaling $56,000 to Defendants Beim, Wertheimer, and Yesod.

Debtor filed bankruptcy on November 16, 1987. On November 30, 1989, Trustee Jay Alix instituted proceedings to recover the transfers made with respect to Loans I and II on the theory that the transfers were fraudulent conveyances or, in the alternative, voidable preferences.

The Bankruptcy Court held that the Debtor's transfers with respect to Loan I were voidable as fraudulent conveyances under 11 U.S.C. § 548 ("§ 548") because it

found that Debtor did not receive reasonably equivalent value and because Debtor was insolvent on the date of the transfers. The Bankruptcy Court also held that transfers related to both loans were voidable preferences under 11 U.S.C. § 547 ("§ 547") because it found that the transfers were made to creditors on account of antecedent debts within the statutory period and gave the creditors more than they would have received in a bankruptcy proceeding. In assessing damages, the Court limited recovery to those Defendants who were the immediate recipients of the transfers. Finding it "inappropriate" to order recovery to persons other than the recipients, the Court declined to order recovery from other insider beneficiaries of the transfers.

III. APPLICABLE LAW

A. The Fraudulent Conveyance Provision: § 548

Title 11 of the Bankruptcy Code enables trustees to void asset transfers made by a debtor where those transfers are determined to be fraudulent conveyances. Section 548 provides in relevant part as follows:

> (a) The trustee may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition, if the debtor voluntarily or involuntarily —
>
> . . .
>
> (2)(A) received less than a reasonably equivalent value in exchange for such transfer or obligation; and

> (B)(I) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;
>
> (ii) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital...

In order for a trustee in bankruptcy to avoid a transfer as fraudulent under § 548, four elements must be satisfied: (1) the transfer must have involved property of the debtor; (2) the transfer must have been made within one year of the filing of the petition; (3) the debtor must not have received reasonably equivalent value in exchange for the property transferred; and (4) the debtor must have been insolvent, been made insolvent by the transaction, be operating or about to operate without property constituting reasonable sufficient capital, or be unable to pay debts as they become due. In re: United Energy Corp. v ABCD Enterprises, 944 F.2d 589, 594 (9th Cir. 1991). Elements relevant to the instant appeal are addressed more fully below.

1. "Interest of the Debtor"

Where there is a question as to whether the transfer in question was the transfer of an interest of the debtor, the Court must determine whether the debtor had such an interest in the funds such that' a transfer thereof would deplete the estate. In re: Hartley, 825 F.2d 1067, 1070 (6th Cir. 1987). The debtor is not deemed to have an interest in assets loaned by a third party for the sole purpose of enabling the debtor to

satisfy the claim of a specific creditor, such as where the funds transferred were "earmarked" by a lender to pay a previous creditor of the debtor. This "earmark doctrine" applies where: (1) the assets in question were never under the control of the debtor; (2) the assets are transferred from a third party to the creditor as a payment for an antecedent debt owed by the debtor; and (3) the debtor's estate is not diminished in value. In re: McLean Industries, Inc. v United States, 162 B.R. 410, 420 (S.D.N.Y. 1993), *reversed on other grounds*, 30 F.3d 385 (2d Cir. 1994).

2. "Reasonably Equivalent Value"

The determination of whether a debtor has received reasonably equivalent value is a question of fact to be determined on a case-by-case basis. In re: Minnesota Utility Contracting, Inc., 110 B.R. 414, 419 (D. Minn. 1990). In determining whether the debtor received reasonably equivalent value, the court should be guided by the purpose of the requirement, which is to conserve the debtor's estate for the benefit of creditors. Id. at 420. Resolution of the question requires inquiry into whether the debtor received "value," and, if so, whether the value was the reasonable equivalent of what was transferred. In re: Chomakos, 170 B.R. 585, 590 (E.D. Mich. 1993). Courts consider a variety of factors in making the determination, including but not limited to, the good faith of the transferee, whether the sale was an arm's length transaction, and the difference in the amount paid compared to the fair market value. In re: Morris Communications NC, Inc., 914 F.2d 458,467 (4th Cir. 1990).

Although no specific test is applied to resolve the question of reasonably equivalent value, certain principles

have evolved from common fact pattern. For example, a debtor is generally considered to have received inadequate consideration if he transfers assets for consideration which passes to a third party, and consideration passing from a subsidiary to a parent corporation will be presumed to be nominal. In re: Grabill, 121 B.R. 983, 994-45 (N.D. III. 1990). Although it is possible that a debtor might benefit indirectly as a result of consideration received by a third party, the benefit received must be fairly concrete. Id. see also Mayo v Pioneer Bank & Trust Co., 270 F.2d 823 (5th Cir. 1959), *cert. denied*, 362 U.S. 962 (1960); Barry Creelman Mill & Plumbing Supply Co. v Zoller, 109 F.2d 924, 926 (2d Cir. 1940). For example, indirect benefit may be found when the benefit goes to a third party with whom the debtor is related. See Rubin v Manufacturers Hanover Trust Co., 661 F.2d 979 (2d Cir. 1981). The central inquiry in the cases involving indirect benefit is the same as in cases involving direct benefits; the Court must consider the net effect on the debtor's estate and the statutory purpose of conserving the estate for the benefit of creditors. See id. at 992.

3. "Insolvency"

The Bankruptcy Code defines "insolvent" to mean "financial condition such that the sum of such entity's debts is greater than all of such entity's property, at a fair valuation. . . . . ."11 U.S.C. § 101(32)(A). The 'fair valuation' of the debtor's condition values the business and/or its assets and liabilities as a "going concern." In re: Nathanson Bros. Co., 64 F.2d 912, 913 (6th Cir. 1933). "Going concern" value is determined by valuing a business' assets and liabilities as parts of the whole at a fair valuation and not as isolated

articles separated from the whole. Id. The presumption that a business is a "going concern" may only be rebutted where the business is "wholly inoperative, defunct, or dead on its feet... ." In re: Bellanca Aircraft Corp, 56 B.R. 339, 387 (D. Minn. 1985). In addition, the Sixth Circuit has cautioned that property should not be considered "dead" because the debtor was on the way to financial ruin. In re: Taxman Clothing Co., Inc., 905 F.2d 166, 170 (6th Cir. 1990).

In resolving the question of insolvency, a Court may consider a variety of factors in its effort to accurately determine a debtor's true financial condition. In re: Sierra Steel, Inc., 96 B.R. 278 (9th Cir. 1989). A Court is not limited to consideration of events occurring prior to the transfers if subsequent information is reliable. Collier on Bankruptcy, ¶ 101.32[5], (15th ed. 1997); In re: Coated Sales, Inc., 144 B.R. 663,668 (S.D.N.Y. 1992). The Court's resolution of the insolvency issue is a factual finding that is reviewed for clear error. In re: Tennessee Chemical Company v Shell Canada, 112 F.3d 234, 236 (6th Cir. 1997).

B. The Preferential Transfer Provision § 547(b)

The preferential transfer provision of the Bankruptcy Code allows the trustee to void transfers made within a short period of time before bankruptcy. The purpose of the provision is two-fold. First, it is intended to discourage creditors from racing to the courthouse to dismember the debtor during the slide into bankruptcy. In re: Hartley, 825 F.2d. 1067, 1069 (6th Cir. 1987). Second, the preference provision facilitates the policy of equality of distribution among creditors of the debtor. Any creditor that received a greater payment than others of his class is required to

disgorge that payment so that all may share equally. Collier, at ¶ 547.01.

The elements of an avoidable preference are set out in § 547(b):

> (1) any transfer of an interest of the debtor;
> (2) to or for the benefit of a creditor;
> (3) for or on account of an antecedent debt owed by the debtor before the transfer was made;
> (4) made while the debtor was insolvent;
> (5) made either within 90 days before bankruptcy, or between 90 days and one year if the transferee was an insider at the time of the transfer; and
> (7) that enables the creditor to receive more than it would receive if the case were under Chapter 7 of the code, the transfer had not been made, and the creditor received payment of its debt to the extent provided by the Code.

In brief, the five characteristics of a voidable preference are that it (1) benefits a creditor; (2) is on account of antecedent debt; (3) is made while the debtor was insolvent; (4) be made within 90 days before bankruptcy; and (5) enables the creditor to receive a larger share of the estate than if the transfer had not been made. Union Bank v Wolas, 502 U.S. 151,154-55 (1991). The Code also provides that the debtor is presumed to have been insolvent during the 90 day period preceding bankruptcy. § 547 (f).

Certain elements of the voidable preference provision are defined in the Bankruptcy Code. The term "creditor" is broadly defined as "an entity that has a claim against the

debtor that arose at the time or before the order for relief concerning the debtor." 11 U.S.C. § 101(9)(A). "Claim" is also broadly defined as a "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated...fixed, contingent ... unmatured, legal, equitable, disputed.. ." 101 (4)(A). Finally, although "antecedent debt" is not defined, "debt" is defined as "liability on a claim" and is construed broadly to be coextensive with the definition of claim. In re: United Energy Corp., 944 F.2d 589, 595 (9th Cir. 1991).

A finding of creditor status within the meaning of § 547(b)(1) is reviewed for clear error. In re: C-L Cartage Co., Inc, 899 F.2d 1490, 1493 (6th Cir. 1990).

C. Recovery By the Trustee Under § 550

Section 550 of the Bankruptcy Code permits recovery of avoided transfers from both the immediate transferees and from those who benefitted from the transfers. That section states:

> (a) Except as otherwise provided in this section, to the extent that a transfer is avoided under section ... 547, 548 ... of this title, the trustee may recover for the benefit of the estate, the property transferred or, if the court so orders, the value of such property, from--
>
> (1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or
>
> (2) any immediate or mediate transferee of such initial transferee.

The rule further provides that the trustee may not recover under (a)(2) if transferee is a good faith purchaser without knowledge of the voidability. § 550 (b)(1)[1]

Under the provisions of this section, the trustee may recover from an outsider transferee for transfers made within the extended preference period of one year when the beneficiary of the transfers is either an insider creditor or an insider guarantor. In re: C-L Cartage Co., Inc. 899 F.2d 1490, 1494 (6th Cir. 1990). A debtor's payments to a lender "benefit" the insider because they discharge the insider's existing or potential liability to the lender. Id..... This interpretation of § 550 flows from the observation that "[i]nsiders, using their knowledge and control over the debtor, have an incentive to cause the debtor to prefer particular outside creditors when the insiders themselves derive benefits from those payments." Id. at 1495. In this respect, the Sixth Circuit has acknowledged that such a reading might seem to penalize a lender for seeking protection of an insider guaranty. However, the Court cautioned that the statute must be strictly adhered to: "Bankruptcy courts ... cannot use equitable principles to disregard the unambiguous statutory language." Id. at 1494 (citations omitted).

IV. DISCUSSION

For the purposes of the instant appeal, the Court

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[1] In 1994, the section was amended in order to overrule line of cases permitting recovery from non-insider transfers during the extended preference period. However, the amendment is not retroactive to transactions occurring prior to 1994, and therefore does not apply in this case. See Pub. L. No. 103-394.

reviews questions of law de novo, and questions of fact using the clearly erroneous standard. In reviewing a question of fact, this Court may find clear error only when it is left with "the definite and firm conviction that a mistake has been committed." United States v United States Gypsum Co., 333 U.S. 364, 395 (1948). Where a question is one of mixed law and fact, it must be broken down into its constituent parts, with the proper standard of review applied to each part. Westbanco Bank Barnesville v Raforth (In re: Baker & Getty Financial Services, Inc.), 106 F.3d 1255, 1259 (6th Cir. 1997).

With the appropriate legal standards in mind, we will address the arguments made by appellants and appellees/cross-appellants.

A. Loan I: Fraudulent Conveyance Under § 548

In order for a trustee in bankruptcy to avoid a transfer as fraudulent under § 548, four elements must be satisfied: (1) the transfer must have involved property of the debtor; (2) the transfer must have been made within one year of the filing of the petition; (3) the debtor must not have received reasonably equivalent value in exchange for the property transferred; and (4) the debtor must have been insolvent, been made insolvent by the transaction, be operating or about to operate without property, constituting reasonable sufficient capital, or be unable to pay debts as they become due. In re: United Energy Corp. v ABCD Enterprises, 944 F.2d 589, 594 (9th Cir. 1991).

Appellants make three arguments for reversal of the Bankruptcy Court's conclusion that Loan I transfers were

fraudulent conveyances. First, Appellants contend that the transfers did not involve property of the debtor as required by § 548. They claim that Debtor merely acted as a conduit for funds of SCPI and that the earmark doctrine should have been applied. Alternatively, Appellants claim that Debtor received reasonably equivalent value for the transfers. Finally, Appellants contend that Debtor was solvent at all relevant times. We address each argument in turn.

Appellants first argue that the transfers did not involve interests of Debtor and that the Bankruptcy Court erroneously failed to apply the earmark doctrine. The "earmark doctrine" applies where: (1) the assets in question were never under the control of the debtor; (2) the assets are transferred from a third party to the creditor as a payment for an antecedent debt owed by the debtor; and (3) the debtor's estate is not diminished in value. In re: McLean Industries, Inc., v United States, 162 B.R. 410, 420 (S.D.N.Y. 1993), *reversed on other grounds*, 30 F.3d 385 (2d Cir. 1994). After reviewing the record before us, we reject Appellants' argument for several reasons.

First, the Bankruptcy Court found that the money transferred involved property of the Debtor, and its finding is supported by the record. Specifically, the Court found that SCPI raised the money from the public offering "and contributed it *as capital* to Debtor, from which Loan I was repaid." Because the money was given to Debtor *as capital*, the Bankruptcy Court concluded that "Debtor, in repaying the loan, was thus *clearly paying out its own money*...." Opinion of the Bankruptcy Court, p.9. The court's finding is supported by the record because Defendants admitted that the sole purpose of the public offering was to provide Debtor with

an infusion of capital. Moreover, Defendant Sanders testified that proceeds were invested in Debtor and *were not a loan* (Tr. 152). Accordingly, this Court upholds the finding that the transfers involved interests of Debtor and finds that earmark doctrine was properly rejected.

Although a finding that the interests transferred were interests of Debtor eliminates the need for further analysis of the earmark doctrine, the Bankruptcy Court provided additional support for its conclusion. We note in particular that the court correctly recognized that Loan I was not a Loan *to SCPI*, but was a *personal* loan to shareholders of Debtor. Thus, Debtor was not merely acting as a conduit to pay the Creditors of SCPI, as SCPI had no obligation on Loan I. Further, having found that the assets transferred were property of Debtor, the transfer of those assets necessarily diminished the value of Debtor's estate, thereby further precluding application of the earmark doctrine. Thus, this Court finds that the Bankruptcy Court correctly rejected Appellants' earmark doctrine/conduit argument with respect to Loan I.

Appellants claim, in the alternative, that Debtor received reasonably equivalent value for the transfer with respect to Loan I such that the third statutory element was not satisfied. Appellants claim that the Bankruptcy Court misapplied the law in its analysis of the "reasonably equivalent value" requirement because it failed to appreciate that a debtor may benefit indirectly as a result of consideration received by a third party. Reviewing the Court's analysis and the cases of In re: Grabill, 121 B.R. 983 (N.D. Ill. 1990), Klein v Tabatchnick, 610 F.2d 1043 (2d Cir. 1979), and others relied on by Appellants, this Court finds no error of

law in the Opinion of the Bankruptcy .Court.

The Bankruptcy Court applied the appropriate legal standard. It noted that generally consideration is inadequate if the transfer is made by the debtor and the consideration passes to a third party, and it also noted that where the claimed benefit is indirect, it must be concrete. Opinion, pp. 10-11. Contrary to Appellants' argument, the Court also considered that "It]here are any number of decided.... cases where a non-obligated corporate debtor pays the debt of an affiliate corporation, or a shareholder,...in which reasonably equivalent value has been found." Opinion, p. 11. The legal standard applied by the Court is the same as that applied in In re: Grabill and the other cases relied on by Appellants.

The court's finding that Debtor did not receive reasonably equivalent value is also supported by the record. Debtor's treasurer testified that he knew of no reason why Debtor would pay the personal loans of Defendants Sanders and Kreissl (Loan I), implying that Debtor received, in essence, no value. Mr. Busch also testified that Debtor received no value in exchange for those transfers and that the transfers were not obligations of Debtor (Tr. 22-23). Although Defendants argued that Loan I eventually led to the public offering for which Debtor received value, the court found that at the time of that Loan, "there were simply too many unknowns, and too many bridges to cross, to be able to find reasonable equivalence running to the debtor...." In light of the evidence presented, we do not find the court's conclusion with respect to the value received by Debtor on Loan I to be clearly erroneous.

Appellants next contend that Debtor was solvent when

the transfers were made, such that the fourth element of the statute was not met. Specifically, Appellants argue that the Bankruptcy Court's consideration of events after the transfers was erroneous because the subsequent information was unreliable. We review Appellants' claims keeping in mind that the determination of insolvency for purposes of § 547(b) is a factual finding that is reviewed for clear error. In re: Tennessee Chemical Company v Shell Canada, 112 F.3d 234, 236 (6th Cir. 1997).

In resolving the question of Debtor's insolvency, the Bankruptcy Court considered the Defendants' arguments for a "value-in-use" valuation, as well as the evidence offered that Debtor was solvent. It then considered the Trustee's argument for market value and the accuracy of the evidence submitted by the Trustee. Mr. Busch testified that Debtor was insolvent and that Debtor's liabilities were about $12 million dollars at their lowest, while Debtor's assets did not exceed $8 million. The "value-in-use" figures submitted by Defendants with respect to the real estate was based on projected profits provided by Defendants and contained an appraisal which cautioned that "value-in-use is a subjective concept...." After considering all the evidence, the court concluded that the Trustee met his burden of proving insolvency, based on its belief that "the 'going concern' value (which is a type of market value), and not the 'value-in-use' (which is not market value) is the appropriate value...." Opinion at 21. Reviewing the evidence presented, we do not find that the Court's acceptance of the Trustee's figures, or its conclusion that Debtor was insolvent, are clearly erroneous.

Because we uphold the finding that Debtor was insolvent at the time of the transfers, we need not address the

issue of whether the transfers left Debtor with insufficient capital. Having found the elements of § 548 satisfied, we uphold the finding that the transfers with respect to Loan I were fraudulent conveyances.

B. Loan II: Preferential Transfer Under § 547

The Court will next address whether transfers involving Loan II were preferential such that they should be voided under § 547.[2] In brief, the five characteristics of a voidable preference are that it (1) benefits a creditor; (2) is on account of antecedent debt; (3) is made while the debtor was insolvent; (4) is made within 90 days before bankruptcy; and (5) enables the creditor to receive a larger share of the estate than if the transfer had not been made. Union Bank v Wolas, 502 U.S. 151,154-55 (1991). The Code also provides that the debtor is presumed to have been insolvent during the 90 day period preceding bankruptcy. § 547 (f').

Appellants contend that the Bankruptcy Court erred in finding that the transfers to Defendants Beim and Wertheimer were voidable preferences because the Trustee did not raise or prove that those Defendants were either creditors or insiders of Debtor as required by the Code. However, the Bankruptcy Court did find that Defendants were creditors. We review a finding of creditor status within the meaning of § 547 for clear error. In re: C-L Cartage Co., Inc., 899 F.2d 1490,

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[2] There is no need to review the Court's holding that Loan I transfers were also preferential transfers, as reversing on that count would not have any practical effect on the case, given the finding that the Loan I transfers were voidable fraudulent conveyances.

1493 (6th Cir. 1990).

The Bankruptcy Court found that Defendants Beim and Wertheimer were creditors of Debtor when it stated "as part of Debtor's defense to the fraudulent conveyance action, Debtor argued that it received reasonably equivalent value in exchange for its payments to its creditors." Opinion, p. 23. Although correctly point out that the court erroneously referred to "Debtor's defense" to the action rather than "Defendants," such a mistake does not require reversal. It is clear that the Bankruptcy Court intended to find that the payments made to Defendants Beim and Wertheimer were payments to *Debtor's creditors*, because the Court explained as much earlier in its opinion. See Opinion, pp. 8-10 (explaining Defendants' defense and stating that "Defendants argue that Debtor received reasonably equivalent value for the monies paid to Beim and Wertheimer..." and then finding that Loan II payments were "payments made by Debtor in respect to monies received directly by Debtor and whose repayment and obligation in respect thereto was made by Debtor.").

The Court's finding that Defendants Beim and Wertheimer were creditors of Debtor is also supported by the record. The proceeds of Loan II, although borrowed in the name of SCPI and guaranteed by Sanders and Kreissl, were paid over and used by Debtor. Debtor also paid the initial finders fee in order to obtain the loan, and Debtor thereafter paid all extension fees and interest on the loan. Thus, Defendants Beim and Wertheimer held claims against Debtor such that they were creditors, as that term is broadly defined in the Code. See In re: Cartage Co. Inc., 899 F.2d 1490 (6th Cir. 1990). In light of evidence that the Loan II money was received by, used by, and financed by Debtor, considering

that the term "creditor" is broadly defined, and considering the Court's characterization of Appellant's defense to the fraudulent conveyance action, we uphold the Bankruptcy Court's finding that Defendants Beim and Wertheimer were creditors of Debtor.

Appellants also argue that the Bankruptcy Court used an erroneous standard of "insider." They claim that the court's finding that Loan II transfers were "arms length transactions" precludes a finding that Defendants Beim and Wertheimer were insiders. We find, however, that Appellants' argument is without merit because the Bankruptcy Court was not required to find that Defendants Beim and Wertheimer were insiders, fail to recognize that a trustee may recover payments made to *non-insiders*, even when those payments were made during the extended preference period, if those payments *benefitted insider creditors or guarantors*. In re: C-L Cartage Co. Inc., 899 F.2d 1490 (6th Cir. 1990)(emphasis added).

The Bankruptcy Court correctly found that the Loan II transfers made in the year prior to the bankruptcy filing benefitted insider guarantors. It was stipulated that Messrs. Sanders and Kreissl were at all relevant times officers and directors of Debtor, and that SCPI was the sole shareholder of the Debtor. Therefore, those three parties are insiders within the meaning of § 101(2), (31)(B) and (E). It is was also admitted that Defendants Sanders and Kreissl guaranteed Loan II; therefore, they benefitted from the transfers made with respect to Loan II. In addition, SCPI was obligated as the recipient to pay Loan II, so it also benefitted from the extension fees and interest paid by Debtor. Accordingly, we find Appellants' argument with respect to the insider status of

Defendants Beim and Wertheimer without merit.

We also uphold the court's finding that the Loan II transfers were made on account of antecedent debts of Debtor. Again, the court's finding is supported by evidence that Debtor was the recipient and beneficiary of the loans, Debtor paid the finders fees, and Debtor assumed the obligation of paying interest and extension fees on the loan. This evidence, combined with the fact that Defendants stipulated to the fact that the payments were made "on account of Loan II", Joint Final Pretrial Order, pp. 8 & 9, are sufficient to overcome any argument that the finding is clearly erroneous.

The Court has already upheld the finding of insolvency and refers back to its earlier discussion in upholding the Bankruptcy Court's finding.

Finally, because all transfers occurred within the statutory period, and because Appellants do not contest the finding that Defendants received more than they would have in a Chapter 7 liquidation, we find that the elements of § 547(b) were met with respect to the Loan II payments.

C. Recovery Under § 550

The final ground on appeal is whether the Bankruptcy Court appropriately limited recovery to Defendants Beim, Wertheimer, and Yesod. Section 550 permits recovery of avoided transfers from the immediate transferees as well as from entities who benefitted from the transfers. The Bankruptcy Court found it "inappropriate" to order recovery of the money from persons other than those to whom Debtor paid it. Opinion p. 25. Reasoning that the issue was the

return of transfers which Debtor paid out, the court limited recovery to those persons who had received transfers.

In declining to impose liability on Defendants Sanders, Kreissl, and SCPI for the transfers, the Bankruptcy Court did not address the plain language of Section 550. That section, as it existed at the time the relevant transfers were made, allowed the trustee to recover from "the initial transferee of such transfer or *the entity for whose benefit the transfer was made* or
any immediate or mediate transferee... ." We also note that the Sixth Circuit has cautioned that, in ordering recovery, bankruptcy courts may not use equitable powers to disregard unambiguous statutory language. In re: C-L Cartage Co., Inc., 899 F.2d 1490, 1494 (6th Cir. 1990). Accordingly, we apply the plain language of the Code.

We find that the Trustee was entitled to recover from Defendants Sanders, Kreissl, and SCPI, as they were entities that benefitted from the transfers made by FSI. Both Sanders and Kreissl benefitted from Debtor's payments to Beim, Wertheimer, and Yesod because they were personally obligated for Loan I and were insider guarantors of Loan II. SCPI also benefitted from the transfers because the proceeds of Loan I were used to form SCPI free of charge and because Loan II was taken out in the name of SCPI. Thus, this Court finds that recovery should have been ordered against Defendants Sanders, Kreissl, and SCPI

In sum, this Court affirms the Bankruptcy Court's holding that Loan I transfers were fraudulent conveyances under § 548, affirms the Bankruptcy Court's holding that Loan II transfers were voidable preferences under § 547(b),

and grants recovery from Defendants Sanders, Kreissl, and SCPI for transfers made with respect to both loans.

IT IS SO ORDERED.

/s/_____
HORACE W. GILMORE
UNITED STATES DISTRICT JUDGE

Dated: October 27, 1997

A TRUE COPY
CLERK U.S. DISTRICT COURT
EASTERN DISTRICT OF MICHIGAN
By/s/_____
DEPUTY CLERK

APPENDIX C

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

Case No. 87-06979

FILED
April 1, 1997

In re:
FRED SANDERS, INC.,
Debtor.
_____/

Case No. 87-06979
Chapter 11
Hon. Walter Shapero

Adv. Pro. No. 89-0876

JAY ALIX, Trustee,
Plaintiff,

v.

SALEK E. BEIM, YESOD INTERNATIONAL, INC., FILIPP J. KREISSL, JOHN M. SANDERS, MORTON J. WERTHEIMER, THOMAS F. DESENA, SR., JOSEPH P. GORYEB, ALLAN J. SCHER, GERALD C. SELKE, CHARLOTTE GERBER TURNER, CARMEN GALDIERI, SCHENK, PRICE, SMITH & KING, SANDERS CONFECTIONERY PRODUCTS, INC., JEFFREY BAYDIN, and LYNDA BAYDIN,
Defendants.
_____/

OPINION FINDING THAT TRANSFERS MADE TO THE DEFENDANTS BY THE DEBTOR ARE VOIDABLE

Introduction

This case is before the Court for the determination of whether $211,000 of transfers made by Debtor to the Defendants are voidable under 11 U.S.C. § 548 and § 547.

Background and Facts

Prior to 1986, Defendants Sanders and Kreissl had become the controlling shareholders of Debtor which had purchased its business assets out of a prior bankruptcy. Apparently concluding that a public offering presented the only, or most feasible, source of needed additional capital, in July 1986, Sanders and Kriessl acquired stock in Tamarac Resources, Inc. ("Tamarac"), an inactive but publicly traded shell corporation. Thereafter, they, as shareholders of Debtor, along with the other shareholders of Debtor, exchanged their shares in Debtor for shares of Tamarac and, as a result, became owners of all of, or the controlling interest in, the stock of Tamarac which then owned the shares of Debtor. Sanders Confectionery Products, Inc. ("SCPI"), a new corporation, was then formed and, in November of 1986 and through a type of merger with Tamarac, SCPI emerged (and succeeded Tamarac) as the corporate parent of Debtor (and thus Sanders, Kriessl and Debtor's former shareholders became SCPI's primary and controlling shareholders). At about that time, SCPI also embarked upon a public offering of what came to be about one-third of its stock in order to obtain the needed operating capital for Debtor. The proceeds of that

public offering were required to be held in escrow and not released until certain minimum sums were raised and/or other conditions satisfied. The pressing and ongoing needs of Debtor for funds prior to and after the public offering, and/or the permitted release of proceeds of the public offering, occasioned the specific transactions at issue in this case. The $4.3 million net proceeds of the public offering were released to SCPI in February or March of 1987 and were apparently immediately contributed by it to Debtor (its subsidiary) as additional capital. That money was then used by Debtor to pay various overdue tax and other pressing obligations as well as make some of the transfers or payments involved in this case.

On or about July 17, 1986, Defendant Wertheimer loaned $65,000 to Kreissl and $65,000 to Sanders ("Loan I"). The loan was originally due to be paid 181 days from the date it was issued. Both Kreissl and Sanders (who were officers and directors of the Debtor as well as SCPI at all relevant times), as individual obligors, signed promissory notes memorializing the repayment terms of Loan I. Kreissl and Sanders used the $130,000 loan proceeds to fund their initial purchase, in their own names, of shares of Tamarac in July 1986. Details of Loan I both as respects the original loan and subsequent events in respect thereto are set forth in Exhibit A.

The second loan ("Loan II") was a ninety-day loan made on or about January 22, 1987. On that date, Beim arranged for various investors, including Wertheimer, to loan a total of $300,000 to SCPI. Although the principal of Loan II was not repaid by Debtor, Debtor paid a finder's fee, extension of the due date fees, and interest to Beim, Wertheimer and Defendant Yesod International, Inc. on

account of Loan II, all as set forth in Exhibit B attached hereto, which likewise details the original loan and subsequent related events.

Debtor filed bankruptcy on November 16, 1987. A chronology of salient events as respects Loan I, Loan II and the bankruptcy filing is attached as Exhibit C.

Based on the described payments and transfers in regard to both Loans I and II, the Trustee claims that Debtor is owed $137,500 in respect to Loan I and $74,000 in respect to Loan II, or a total of $211,500 allocable between the following Defendants:

Wertheimer, Beim and J. Sanders, jointly and severally	$68,750
Wertheimer, Beim and Kreissl, jointly and severally	$68,750
Beim and SCPI, jointly and severally	$41,000
Wertheimer and SCPI, jointly and severally	$15,000
Beim, Yesod International and SCPI, jointly and severally	$18,000

plus statutory interest from November 30, 1989, the date the complaint was filed.[1]

The Trustee argues that the payments which Debtor

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[1] The Trustee settled his claims against the other named defendants.

made on account of Loan I and Loan II were fraudulent conveyances avoidable under § 548(a)(2) and recoverable under § 550(a) and (b), in that such payments were made within one year before the date of filing the petition, Debtor received less than a reasonably equivalent value in exchange for such payments, and Debtor was either insolvent on the date such payments were made or was engaged in a business for which there was an unreasonably small capital.

Alternatively, the Trustee argues that if the Court finds that Debtor received value in exchange for the payments, all of the payments are recoverable under §§ 547 and 550 as avoidable preferences made on behalf, of or for the benefit of, insiders.

Debtor argues that: (1) Debtor did not make any transfers for less than reasonably equivalent value because Debtor did not transfer the, or its, funds (i.e. it was acting in fact as a disbursing agent for SCPI with respect to the latter's money) and, in the alternative, if it did transfer the funds, it received reasonably equivalent value; and (2) Debtor was solvent and was not engaged in a business for which it had insufficient capital at the time of the transfers.

Law and Discussion

The issues under 11 U.S.C. § 548 are: (1) did Debtor receive less than a reasonably equivalent value in exchange for a transfer or obligation; and (2) was Debtor insolvent or

engaged in a business for which it had insufficient capital.[2] The Trustee also raises issues under 11 U.S.C. § 547. The Trustee has the burden of proving all elements necessary to establish claims under § 548 and § 547. See, e.g., In re Minnesota Utility Contracting, Inc. (Fleet National Bank in Anoka v. Minnesota Utility Contracting, Inc.), 110 B.R. 414, 417 (D. Minn. 1990) and In re Sierra Steel, Inc., 96 B.R. 275, 277 (9th Cir. BAP 1989).

I. **Did the Debtor receive reasonably equivalent value in exchange for the transfers for purposes of § 548 (a) (2) (A) ?**

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[2] Section 548 states, in part:

(a) The trustee may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition, if the debtor voluntarily or involuntarily --

* * *

(2) (A) received less than a reasonably equivalent value in exchange for such transfer or obligation; and

(B) (i) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;

(ii) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital;

* * *

In order to determine whether the Debtor received "reasonably equivalent value", this Court must initially analyze and evaluate Loan I separately from Loan II.

With respect to Loan I, the Trustee points out that (1) Sanders testified that he and Kreissl used the proceeds of the loan to purchase shares in Tamarac in their own names, which shares (and the resulting shares of SCPI issued incident to the SCPI/Tamarac merger) they, or at least Sanders, still own, and (2) those shares were in addition to the shares received incident to their formation of SCPI and/or shares of SCPI representing their initial stock in Debtor.[3] Debtor's treasurer for the period in question testified that he knew of no reason why the personal obligations of Sanders and Kreissl (the $130,000 loan used to purchase the stock in Tamarac) should have been paid by Debtor, and thus the Trustee argues Debtor received, in essence, no value.

With respect to Loan II, the Trustee argues that Debtor did not receive reasonably equivalent value, noting that the Defendants presented no evidence to rebut the Trustee's evidence that the finder's fee, extension fees and interest payments were not exchanged for "reasonably equivalent value". That evidence emanated from Debtor's treasurer who testified that the interest rates charged on the loans were "exorbitant". For example, the per annum interest rate in

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[3] Thus it appears their stock interests in SCPI emanated from (a) its original incorporation by them and (b) its merger or equivalent with Tamarac Resources, Inc. and some stock exchange incident thereto and (c) prior stock ownership in Debtor and some sort of stock exchange incident to Debtor becoming a subsidiary of SCPI.

respect to the $50,000 loan (part of Loan II) to SCPI on April 16, 1987 was 30%. The $50,000 loans (also part of Loan II) obtained on August 14, 1987 and on October 14, 1987 carried per annum interest rates of 60%. Therefore, the Trustee argues, even if Debtor received the full Loan II proceeds (a fact alluded to, but not stated directly or proven by Defendants but which the Court believes to be true), its payment of extension fees and the indicated interest rate were not "reasonably equivalent value" for the loans by reason of the excessive amount.

The Defendants argue that the Trustee's arguments fail for two reasons. First, as noted, Debtor did not transfer funds to Beim and Wertheimer (and, therefore, there was no "transfer" for purposes of § 548) because the money paid to Beim and Wertheimer was, in essence, SCPI's money, stating that Debtor issued the check only because SCPI did not have its own checking account. In other words, Debtor argues it operated as a mere conduit for SCPI and the money from the loans and the public offering went to SCPI who passed most, if not all, of it to Debtor in exchange for which SCPI needed Debtor to write, on its behalf, the checks totalling approximately $211,000 as respects both Loan I and Loan II.

In the alternative, Defendants argue that Debtor received reasonably equivalent value for the monies it paid Beim and Wertheimer because, without the repayment of those sums, Beim and Wertheimer would not have lent Debtor the money and that money enabled Debtor to obtain the proceeds of the public offering of its parent corporation, SCPI. Sanders testified the proceeds of the Beim and Wertheimer loans permitted the acquisition of Tamarac (later, SCPI), and the additional funds were used to finance the

public offering because the costs of the offering are always the first expenses paid out of proceeds. Debtor eventually received approximately $4,750,000 as a capital contribution (and not a loan) from SCPI and, therefore, it is argued Debtor thereby received reasonably equivalent value.

With respect to the Debtor's first theory (the conduit theory), it does not work in any event with reference to Loan I. That loan was to neither SCPI nor Debtor so to argue Debtor really paid out SCPI's money in respect to that loan does not deal with the inherent problem that it would be as inappropriate for SCPI to repay its shareholders' loans as it would be for Debtor to do so. In sum and substance, the Loan I transaction is akin to, and analytically analogous to, a situation where an existing shareholder personally borrows money (say from a bank) to purchase additional shares and the corporation repays the loan. The fact that the additional shares may have enabled the shareholder to accomplish something of benefit to the corporation does not permit one to ignore the distinction between corporation and shareholder or to fail to appreciate the corporation was not obligated to repay the loans, or to understand and appreciate that the primary value and benefit involved was the enhancement or increase in the value, or the potential value, of the shareholders' stock interest in the corporation. Furthermore, Debtor argues that the separation of SCPI and Debtor (and their shareholders) for purposes of raising money and contributing it as additional capital should be used and respected but ignores this when it comes to a fraudulent conveyance analysis. SCPI raised the money from the public offering and contributed it as capital to Debtor, from which Loan I was repaid. Debtor, in repaying the loan was thus clearly paying out its own money and not acting as an agent for SCPI.

Actually, Debtor makes the same conduit argument with regard to Loan II as well. The difference between Loan I and Loan II was that in the case of the former, the funds involved were not directly received by Debtor and Debtor was not obligated for their repayment. However, whatever the source of the monies paid out by Debtor, it must be concluded that, in all cases, Debtor was paying out its money (i.e. primary money contributed by SCPI to it as capital). The logic and consistency of Debtor's conduit argument (i.e. payments by Debtor were payments on behalf of SCPI) fails particularly when it is applied in the case of Loan II to payments made by Debtor in respect to monies received directly by Debtor and whose repayment and obligation in respect thereto was made by Debtor, where SCPI does not appear to have really been involved.

With respect to what may have been considered reasonably equivalent value with respect to both, and each, of Loans I and II and with respect to the legal principle applicable to "reasonably equivalent value" or "fair consideration" (considered synonymous), such may be said about these kinds of "triangular" situations:

> (1) generally speaking the consideration is less than fair or is inadequate if the transfer is made by the debtor and the consideration passes to a third party;
>
> (2) indirect benefits to a debtor in such a situation can be the required consideration or value particularly where:

> (a) the other person was the conduit for the direct benefit which really passed to the debtor; or
>
> (b) there was such an identity of interest between the other person and the debtor that it can be fairly said the debtor was the party receiving all or part of the benefit.
>
> (3) if the claimed benefit is indirect, it must be concrete and itself reasonably equivalent to the value transferred and the benefit must have been received in exchange for the transfer.

See, e.g., In re Grabill Corp., 121 B.R. 983 (Bankr. N.D. Ill. 1990); 2 David G. Epstein et al., Bankruptcy, § 6-49 (West 1992).

The quantification of value, or comparison of what went out with what went in, is determined by a "totality of circumstances" test. See, In re Chamakos, 170 B.R. 585 (Bankr. E.D. Mich. 1993), aff'd, 69 F.3d (6th Cir. 1995), cert. denied sub. nom., Allard v. Hilton, 116 S. Ct. 1568 (1996).

There are any number of decided cases in factual situations where a non-obligated corporate debtor pays the debt of an affiliate corporation, or a shareholder, or encumbers its property to collateralize a loan to the affiliate or shareholder in which reasonably equivalent value has been found. In most, however, the proceeds of the loans to the shareholders, or affiliate, went directly to or was used directly for the benefit of the debtor or payor, or some debt or

obligation of the debtor was contemporaneously released or discharged -- all under circumstances that, using a balance sheet test, one could fairly say that creditors of the debtor were not the worse for the transaction.

The kind of indirect benefit argued for in this case is not easily valued, much less its reasonable equivalence to something else. Looking at Loan I as of July 1986, it enabled the acquisition of stock as only the first step in a series of complicated transactions ultimately leading to a public offering of stock of what would later become Debtor's parent, with then unpredictable results. As of that time, there were simply too many unknowns, and too many bridges to cross, to be able to find reasonable equivalence running to Debtor. Debtor neither received the proceeds of the loan or the stock it was used to purchase. What it then received was the essentially unmeasurable potential of what eventually occurred. When Debtor paid Loan I in April of 1987, Debtor had already received the proceeds of the public offering from SCPI. Debtor was not itself legally obligated to pay the loan. Debtor had already received the proceeds of additional loans from SCPI (and thus did not have to pay the loan to receive them). The best that might be said is that such payment may have had something to do with the contemporaneous extension of the due date of Loan II. Even if that were the case, the only evidence before the Court is such that the terms of, and the consideration paid for, the Loan II extensions stood on their own, and the repayment of Loan I at that time would at best not fairly equate to the Loan II extensions which appear to have been given for various other concrete and specific considerations. The same facts and reasons require the conclusion that there was not the necessary quid pro quo or exchange as of the time of the transfer (or for that matter the

Loan itself).

As respects Loan II, the more traditional analysis of relevant factors set forth in the cited cases may be used.

(1) Were the transactions conducted at arms-length?

This Court finds that the Loan II transactions requiring pre-paid interest and extension fees were arms-length transaction. An arms-length transaction requires (a) actions of essentially unrelated willing parties, each being relatively free to act in what each perceives to be his or her own self-interest, (b) actions which are voluntary (as opposed to being under compulsion or duress), and (c) actions which generally take place in an open market. Black's Law Dictionary 57 (5th ed. 1983). In this case, the parties were unrelated willing parties each acting in his own best interest, the parties acted voluntary and without any physical duress, and this type of loan transaction generally takes place in an open market. Therefore, this Court finds that the payment of pre-paid interest and extension fees for Loan II was an arms-length transaction.

(2) Was property or value transferred to Debtor?

In this case, the value transferred to Debtor was the Defendants' willingness to extend the repayment date for Loan II. Had the Defendants insisted on foreclosing on the loan on its due date of April 16, 1987, the Debtor would not have been able to proceed with the public offering. The public offering brought in five million dollars to Debtor.

The Trustee argues, that Debtor did not receive

"reasonably equivalent value" because the interest rates on the loan was "exorbitant". The per annum rate of the $50,000 loan (part of Loan II) to SCPI on April 16, 1987 was 30%. The $50,000 loans (part of Loan II) obtained on August 14, 1987 and on October 14, 1987 had per annum interest rates of 60%. Therefore, Debtor's payment of extension fees and interest as high as 60% per annum was not "reasonably equivalent value" for the loans.

This Court finds that value was transferred to Debtor when the Defendants allowed Debtor to extend the time for the repayment of Loan II. Furthermore, with respect to the interest charged for Loan II, this Court finds that Debtor was fortunate to be able to obtain a loan at all and could not expect to obtain a loan at a bank interest rate. The loan to Debtor, considering its unpredictable economic position, had a fair amount of risk which would justify a high interest rate.

(3) **Did Debtor receive additional valuable benefits as a result of the transaction?**

The value, or even the potential value, of the stock purchased with Loan I can be said to have ended up in the hands of Debtor. What happened here was that the stock purchased by Sanders and Kreissl with the proceeds of Loan I, became (when combined with the stock in SCPI and Debtor already owned by them) the vehicle through which they were able to utilize SCPI to make a public offering of its stock, the proceeds of which ultimately went to Debtor. This Court finds, as discussed above, that Debtor received the valuable benefit of being able to move forward with the public offering.

(4) Did the Debtor act in ""good faith"" with respect to the transaction for purposes of § 548(a)(2)(B)?

The court in Morris explicitly considered good faith as part of its inquiry for determining if "reasonably equivalent value" had been given. The primary inquiry on this point is whether the transferee knowingly participated in acts or as part of a plan to hinder or defraud creditors. A "yes" answer would support the avoidance of the transaction. A "no" answer would support not doing so. This Court finds that there is no proof here that prepaying the interest and paying the extension fees was not done in the good-faith belief that extending the loan would be of benefit to the estate.

In summary, this Court finds that the Debtor received "reasonably equivalent value" for Loan II but did not receive "reasonably equivalent value" for Loan I.

II. Was the Debtor insolvent or engaged in a business for which it had insufficient capital?

The Bankruptcy Code defines "insolvent" to mean "financial condition such that the sum of such entity's debts is greater than all of such entity's property, at a fair valuation. . ." 11 U.S.C. § 101(32)(A). The statutory definition of "insolvent" is essentially the adoption of the so-called "balance sheet" test of insolvency, that being a determination of whether a debtor's debts (liabilities) exceed its property (assets), at "fair valuation". In re Fassnacht & Sons, Inc., 826 F.2d 458, 462 (6th Cir. 1987).

The concept of "fair valuation" presumptively values

the business and/or its assets and liabilities as a "going concern". In re Nathanson Bros. Co., 64 F.2d 912, 913 (6th Cir. 1933). "Going concern" value is determined by valuing a business' assets and liabilities as parts of the whole at a fair valuation, and not as isolated articles separated from the whole. Id. The presumption that a business is a "going concern" may be rebutted, but "[o]nly where a business is wholly inoperative, defunct, or dead on its feet, will going concern valuation be abandoned in favor of an item-by-item fair market valuation." In re Bellanca Aircraft Corp., 56 B.R. 339, 387 (Bankr. D. Minn. 1985), aff'd in part and remanded in part on other grounds, 850 F.2d 1275 (6th Cir. 1988); In re Vadnais Lumber Supply, Inc., 100 B.R. 127, 131 . (Bankr. D. Mass. 1989) ("liquidation value is appropriate, however, if at the time in question the business is so close to shutting its doors that a going concern standard is unrealistic."). However, the Sixth Circuit cautioned that property should not be considered "dead" because the debtor was on the way to financial ruin. In re Taxman Clothing Co., Inc., 905 F.2d 166, 170 (6th Cir. 1990).

In determining fair valuation, the Court first notes that balance sheets are not controlling in insolvency determinations, and the Court should consider other facts in order to more accurately reflect a debtor's true financial condition. In re Sierra Steel, Inc., 96 B.R. at 278; In re Ohio Corrugating Co., 91 B.R. 430, 438 (Bankr. N.D. Ohio 1988). The use of the "balance sheet" test to determine insolvency does not require that what appears on the balance sheet (or does not appear on it) be either conclusive or ignored.

This Court must consider events occurring after the 1/27/87, 4/16/87, 4/22/87, 8/13/87, 9/11/87, 10/13/87

transfer dates. This Court finds no logical reason to distinguish between the usefulness of events occurring prior to the transfer dates from those events occurring after the valuation date in this, a necessarily retrospective and often theoretical, valuation process. What is really important is whether those events are reliable enough to be considered or whether, or to what extent, any changes or intervening circumstances are such as to make them unreliable or irrelevant. For instance, the court in In re Coated Sales, Inc., 144 B.R. 663, 668 (Bankr. S.D.N.Y. 1992) stated:

> Nonetheless, the court may consider information "originating subsequent to the transfer date if it tends to shed light on a fair and accurate assessment of the asset or liability as of the pertinent date (transfer date)." In re Chemical Separations Corp., 38 B.R. 890, 895 (Bankr. E.D. Tenn. 1984). This assures that the valuation is based in reality.

See also, In re Sierra Steel, Inc., 96 B.R. at 278 (9th Cir. BAP 1989) ("there is no policy reason why judges should not be allowed to consider subsequent events"). It has been stated that information obtained subsequent to the transfers may be interpolated to a prior date, if such procedure appears to be reliable. Collier, at ¶ 101.32[5]; In re Ohio Corrugating Co., 91 B.R. at 437.

Because the parties agree that liabilities, at their lowest point, in April 1987 were approximately $11.5 to $12 million, this case turns on the valuation of the assets, more specifically the equipment and the real estate.

In this case, the Debtor argues for a "value-in-use" valuation during the ten-month period in which the transfers occurred. According to the Schostak Brothers Appraisal (Plaintiff's Exhibit 29, p. 3), "value-in-use" is defined as:

> A value concept based on the productivity of an economic good. The concept of use value centers on the contributory value of the real estate to the enterprise of which it is a part without regard to highest and best use or what might be financially realized upon its sale.

In that appraisal, the "value-in-use" of the real estate is $4,719,000 and the "value-in-use" of the equipment is $6,125,000. Apparently, the Defendant equates "value-in-use" with "going concern" value.

The Defendants argue that Debtor is solvent based on the following evidence:

(1) The balance sheet prepared by Deloitte for December 27, 1986, the Deloitte pro forma (unaudited) for December 27, 1986, and the internal unaudited balance sheet (not admitted but testified to) shows a net worth ranging from 3.2 to 7.8 million. (Plaintiff's Exhibit 28).

(2) Debtor raised $600,000 from First Independence Bank in July 1987 which must have required a financial showing. (T.47).

(3) Mr. Walsh, Debtor's expert, concluded that Debtor was solvent with a net worth of $2.5 million at the end

of April 1987. This number is based upon the $2,754,000 net worth after the SCPI offering capital, less the $200,000 in losses in April-May 1987 plus $2,400,000 in excess of building value over the audited balance sheet by May 1987. (T.93).

(4) The public offering ran from February through May 1987, during which one-third of the stock was sold for five million dollars, leading this Court to believe that all of the stock would have a net worth of fifteen million dollars.

(5) On December 11, 1987, the Trustee filed a pleading in this case that the going concern value of Debtor was over $10 million.

(6) Deloitte reviewed the business plan for one year ahead and considered the events occurring up to August 1987. Approximately $192,000 of the total $211,500 of the transfers in issue took place under the auspices of the audit.

On the other hand, the Trustee argues that the "value-in-use" should not be used and, instead, market value should be used. The Trustee relies on the market value figure in Plaintiff's Exhibit 29 of $465,000 for the real estate and on the Norman Levy appraisal in summer 1987 of 2.2 million for the equipment.[4] The Trustee argues that its numbers are more accurate because:

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[4] The Norman Levy appraisal was testified to but was not admitted as evidence.

(1) The internal unaudited financials and Mr. Walsh's testimony on insolvency are unreliable, and without support, because Mr. Walsh based his opinion of Debtor's financial condition as of April 18, 1987 on a purported balance sheet dated April 17, 1987 which was not introduced into evidence. The Defendants produced no evidence as to who prepared it or when it was prepared, and Mr. Walsh did not know. The Defendants presented no evidence as to whether it was complete or accurate.

(2) The pro forma, unaudited balance sheet in the audited financials is also unreliable because the auditors stated in their report:

> The pro forma (unaudited) balance sheet is not necessarily indicative of the actual financial position that has been achieved by the Company as of any date. (PE 28, p. F-27)

Although Mr. Walsh disagreed with the above qualification, claiming that the audit was merely qualified by a standard qualification (that business plans might have to be modified if working capital availability changed), it was qualified nonetheless.

(3) The appraisal set forth in Plaintiff's Exhibit 29 is itself replete with disclaimers as to the reliability of the "value-in-use" figure of $6,125,000 for the real estate. It was based on Debtor's projections of making profits for the years 1985-89 of $377,550, $736,700, $1,372,850, and $1,824,650, respectively and contains the following qualification:

> Certain conclusions contained in this report were derived from projections and other economic data provided by the client and are subject to adjustment in the event that such projections or other data prove to be inaccurate or unrealistic.

Plaintiff's Exhibit 29, p. 37. The projected profits never occurred. Debtor has losses in 1985 (1.25 million), 1986 ($2.5 million) and 1987 ($3.3 million). Further, the appraisal stated:

> Value-in-use is a subjective concept, and we believe that the plant clearly has value to the owner substantially beyond its market value, value that it might not have to another occupant. It is important to emphasize that value-in-use is not market value, is not the same as market value and may have nothing more to do with market value than the fact that market value is numerically a part of the value-in-use.

Plaintiff's Exhibit 29, p. 16. (emphasis added).

(4) The evaluation of the equipment at the fair market value by the Trustee's expert, Mr. Busch, relying on the appraisal by Norman Levy in the summer of 1987 of $2.2 million, is more reliable than the December 1986 financial statement figure of $4.7 million, which reflects other considerations as to the value of the equipment.

(5) Mr. Walsh ignored completely all events which occurred after April 18, 1987, a position which this Court rejected as being antithetical to case law and logic in B&E Sales. Mr. Busch's testimony is supported by the events which occurred within one year of April 1987, including the sale of all of the Debtor's assets as a going concern for a total price of approximately $5,000,000 in April 1988. Such events were relevant to and indicative of the value of Debtor's assets during 1987.

The Trustee argues that market value should be used and that there is a preponderance of the evidence which shows that Debtor was insolvent at the time of each transfer in question.

This Court finds that the Trustee has met his burden in proving Debtor's insolvency at the time of the transfers. This Court bases this finding on its belief that the "going concern" value (which is a type of market value), and not the "value-in-use" (which is not market value) is the appropriate value to place on Debtor's real estate and equipment. "Value-in-use" contemplates the value of an asset to a particular business-owner while "going-concern" value is the value contemplated by the sale of an entire business. When the "going concern" values of the real estate and equipment are factored into the Debtor's overall financial picture, it is clear that Debtor was insolvent at all relevant times during 1987.

Furthermore, based on the summary balance sheet submitted by the Defendants, Debtor's "Net Worth at Fair Value" from December 27, 1986 through October 13, 1987 ranged from $3,259,000 to $7,844,000. (Defendants' Trial Brief, p. 15). These numbers include $4,700,000 for the

equipment and $6,125,000 for the real estate (for a total of $10,825,000). Because this Court accepts the Trustee's figures with respect to equipment and real estate (those being $2.2 million and $465,000 respectively for a total of $2,665,000), the figures presented by the Defendants must be reduced by $8,160,000 (that being the difference between $10,825,000 and $2,665,000). Reducing the "Net Worth at Fair Value", as identified by the Defendants, by $8,160,000 shows that the Defendants were insolvent at all relevant times.

In summary, because Debtor did not receive reasonably equivalent value and because Debtor was insolvent on the date of the transfers, Debtor's transfers to the Defendants with respect to Loan I are voidable. Because this Court has found that Debtor was insolvent, this Court need not determine whether the transfers left Debtor with insufficient capital.

III. Are the transfers avoidable as preferences under § 547(b)?

The Trustee argues, if this Court does not find that all of the transfers were fraudulent conveyances, this Court should find. that the transfers are voidable preferences under § 547(b). Section 547(b) states:

> Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property –

(1) to or for the benefit of a creditor;.
(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
(3) made while the debtor was insolvent;
(4) made --
(A) on or within 90 days before the date of the filing of the petition; or
(B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
(5) that enables such creditor to receive more than such creditor would receive if --
(A) the case were a case under chapter 7 of this title;
(B) the transfer had not been made; and
(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

This Court finds that the Trustee has shown that all of the elements of § 547(b) have been met. First, this Court finds that Debtor made transfers to or for the benefit of a creditor (§ 547(b)(1)) because, as part of Debtor's defense to the fraudulent conveyance action, Debtor argued that it received reasonably equivalent value in exchange for its payments to its creditors. Second, this Court finds that the transfers were made on account of antecedent debts (§ 547(b) (2)) because Debtor has admitted such. (Joint Final Pretrial Order). Third, this Court has found that Debtor made these transfers while it

was insolvent (§ 547(b) (3))(see section II, supra).[5]

Fourth, the Loan II transfers occurring on August 13, 1987, September 11, 1987 and October 13, 1987 all occurred within 90 days before the date of the bankruptcy filing and therefore, § 547(b)(4) is met with respect to those transfers. Section 547(b)(4) is also met with respect to the Loan II transfers occurring on January 27, 1987, April 16, 1987 and April 22, 1987 because the Trustee may recover the transfers to Beim, Wertheimer and Yesod which occurred during the one-year period prior to the filing because those transfers benefitted Sanders and Kreissl, who are both insiders. See, Ray v. City Bank & Trust Co. (C-L Cartage Co., Inc.), 899 F.2d 1490 (6th Cir. 1990).[6] It was stipulated that Sanders and Kreissl were at all relevant times officers and directors of Debtor and that SCPI was the sole shareholder of Debtor. Therefore, those three parties are insiders. 11 U.S.C. § 101(2), (31)(B) and (E). Finally, this Court finds that the recipients of the transfers received more than they would have in a Chapter 7 liquidation (§ 547(b)(5)), relying on Mr. Busch's testimony which was based on the Trustee's liquidation analysis (Plaintiff's Exhibit 2) and the results of

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[5] This Court also notes, with respect to § 547(b)(3), that in preference actions the Debtor is presumptively insolvent during the ninety-day period prior to the bankruptcy filing. This presumption, however, is unnecessary here because the Court has found that the Debtor was insolvent at the time of all of the transfers.

[6] The October 1994 amendments to § 550 are not retroactive as to cases commenced prior to October 22, 1994. Pub. L. No. 103-394.

the Chapter 11 plan.

The Defendants argue, in their brief, that the elements of § 547 have not been met because "the variances in business circumstances produce different business practices" and, "[t]herefore, the structuring and payments made by the Defendants were reasonable under the circumstances", citing In re Carled, Inc., 91 F.3d 811 (6th Cir. 1996) for this proposition. This Court finds that Carled is a case decided under § 547(c) (2) and, because § 547(c)(2) was not raised in this case, the Carled case does not apply.

In summary, this Court finds that the Loan I transfers are avoidable under § 548 and § 547 and the Loan II transfers are avoidable under § 547.

IV. What Are the Damages and Who Are They Assessed Against?

The Court is aware that Defendants did not appear to seriously contest Plaintiff's conclusions in respect to this matter but the Court has concluded it is free to, and should, deal with the issue as hereinafter indicated.

The total amount paid by Debtor on Loan I, recovery of which is sought in this action, was $137,500. Plaintiff seeks one-half of that ($68,750) from the persons indicated on page four of this opinion. The facts with reference to what was paid by Debtor and to whom are set forth in Exhibit A, paragraph 7. It would seem inappropriate to order recovery of the money from persons other than those to whom Debtor paid it. While Wertheimer loaned the money to Sanders and Kreissl, what is involved directly here is the return of that

which Debtor paid out. Accordingly, as to Loan I amounts, Debtor is entitled to a judgment against Beim in the amount of $7500, and Beim and Wertheimer, jointly and severally, for $130,000.

As to the amount paid by Debtor in respect to Loan II, such are detailed in Exhibit B. The original loans were made to SCPI which contributed the monies as additional capital to Debtor. In addition to seeking recovery from those to whom Debtor made payments, the Plaintiff seeks recovery of those sums from SCPI. As in the case of Loan I, the Court deems it inappropriate, given the indicated facts, to order recovery of the money paid out by Debtor from other than the recipients of the payments, as are detailed in paragraph nine of Exhibit B.

The Plaintiff shall submit an order consistent with this Opinion.

/s/_____
Walter Shapero
United States Bankruptcy Judge

Dated: April 1, 1997

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A TRUE COPY
CLERK, U.S. BANKRUPTCY COURT
EASTERN DISTRICT OF MICHIGAN
BY: /s/_____
Deputy Clerk April 1, 1997

EXHIBIT A

Loan I

Wertheimer loaned $130,000 to each of Sanders and Kreissl, individually, ($65,000 loaned to each) under identical terms:

(1) date of loans: July 17, 1986;

(2) repayment due date: January 13, 1987 (by way of a check for $130,000 payable to Beim and endorsed by him and delivered to Sanders);

(3) interest prepaid in form of transfers of stock of Tamarac owned by Sanders and Kreissl;

(4) collateral for repayment obligation: stock of Tamarac owned by Sanders and Kreissl;

(5) by agreement dated January 22, 1987, the due date was extended to April 16, 1987. The stipulation of facts recites the payment of $7,500 on January 21, 1987 as a "roll-over" fee (presumably as the consideration for this due date extension). The contemporaneously written agreement recites the transfer of SCPI stock as the consideration for the extension;

(6) the $130,000 was repaid by Debtor on or about April 16, 1987 by check for $130,000, payment to both Beim and Wertheimer;

(7) payments made by Debtor, as stipulated to by the parties:

date	amount	payee	item
1/21/87	$ 7,500	Beim	"roll-over" fee
4/16/87	$130,000	Beim/ Wertheimer	principal repayment

It is further stipulated these amounts were received by Wertheimer.

(Exhibit A Page 1 of 1)

EXHIBIT B

Loan II

SCPI borrowed a total of $300,000 from various lenders, incident to which Defendant Yesod was to receive a payment of $18,000 as a finder's fee (pursuant to an agreement between Debtor and Yesod dated July 12, 1986). Wertheimer's portion of the $300,000 was $50,000. The proceeds of the loans were paid over and used by Debtor. The terms are as follows:

(1) borrower: SCPI (payment guaranteed by Sanders, Kreissl);

(2) loan date: January 27, 1987;

(3) payment due dates: April 16, 1987 for monies borrowed on or before January 22, 1987, or ninety-days after date of any subsequent advance;

(4) interest: either shares of SCPI (redeemable by cash payments) or cash in advance;

(5) finder's fee of $18,000 paid by Debtor on January 27, 1987

(6) on April 17, 1987, due dates extended to August 14, 1987, in consideration of recited payment of total of $30,000; a new note for $50,000 due August 14, 1987 was issued by SCPI to Wertheimer, reciting prepayment of $5,000 interest (presumably similar notes were issued to the others);

(7) as of August 14, 1989, the due dates of August 14, 1987 were extended to September 13, 1987; a new $50,000 note was issued by SCPI to Wertheimer, noting prepaid interest of $2,500 (presumably similar notes were issued to others);

(8) the record does not fully account for what happened on September 13, 1987 (other than a stipulated payment to

(Exhibit B Page 1 of 2)

Wertheimer of $2,500 as "interest" and $6,000 to Beim as an extension fee) but "as of" October 14, 1987, SCPI issued a new note to Wertheimer for $50,000 with a due date of December 14, 1987 reciting prepaid interest of $5,000;

(9) payments made by Debtor:

(a) to Beim

Date	Amount	Item
1/27/87	$18,000	finder's fee
4/16/87	5,000	interest
8/13/87	6,000	extension fee
9/11/87	6,000	extension fee (NSF but replaced by a later check)
10/13/87	6,000	extension fee
Total	$41,000	

(b) to "Yesod/Beim"

Date	Amount	Item
4/22/87	$18,000	extension fee

(c) to Wertheimer

Date	Amount	Item
4/16/87	$5,000	interest
8/13/87	2,500	interest
9/11/87	2,500	interest
10/13/87	5,000	interest
Total	$15,000	

(Exhibit B Page 2 of 2)

EXHIBIT C

Salient Events Chronology

July 1986	(1) Kreissl/Sanders borrow $130,000 from Wertheimer to buy Tamarac stock;
	(2) Kreissl/Sanders buy stock in and acquire apparent control of Tamarac; through a stock exchange, Debtor becomes a subsidiary of Tamarac and former shareholders of Debtor thereby become controlling shareholders of Tamarac;
August 1986	SCPI was formed;
November 1986	Tamarac merged into SCPI and Debtor becomes subsidiary of SCPI and shareholders of Tamarac become shareholders of SCPI;
December 1986	public offering of additional shares of SCPI (to extend to February 1987);
January 1987	(1) January 13, 1987 due date of July 1986 $130,000 Wertheimer loan to Kreissl/Sanders extended to April 16, 1987;
	(2) SCPI obtains additional $300,000 in loans with due date of April 1987 and Debtor pays interest and finder's fees; Loan proceeds

(Exhibit C Page 1 of 2)

	presumably given to and used by Debtor;
February/ March 1987	SCPI receives net proceeds of public offering and contributes same as capital contribution to Debtor;
April 1987	(1) $130,000 Wertheimer loan to Sanders/Kriessl repaid in full by Debtor;
	(2) due dates of additional $300,000 in loans extended to August 1987; interest and fees paid by Debtor;
August 1987	due dates of additional $300,000 in loans extended to September and interest and fees paid by Debtor;
September 1987	due dates of said $300,000 loans further extended to October and interest and fees paid by Debtor;
October 1987	due dates of said $300,000 loans further extended and interest and fees paid by Debtor;
November 1987	Debtor files chapter 11 bankruptcy.

(Exhibit C Page 2 of 2)

Supreme Court, U.S.
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No. 98-1321

In The

Supreme Court of the United States

October Term, 1998

SALEK E. BEIM, et al.,

Petitioners,

v.

JAY ALIX, Trustee,

Respondent.

On Petition For Writ Of Certiorari
To The United States Court Of Appeals
For The Sixth Circuit

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Should petitioners be granted certiorari where they do not claim any error of law occurred below, where petitioners merely disagree with the Bankruptcy Court's findings of fact, and where those findings were affirmed by the District Court and by the Court of Appeals?

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

STATEMENT OF THE CASE

The facts crucial to the appeal were summarized by the Court of Appeals in its opinion affirming the opinions of the Bankruptcy Court and of the District Court:

> "Prior to 1986, Defendants-Appellants Sanders and Kreissl had become the controlling shareholders of Debtor and concluded that a public offering was necessary to provide Debtor with needed capital. Each of them obtained a personal loan from Appellant Wertheimer for $65,000 on July 17, 1986 ("Loan I"). They signed promissory notes memorializing the repayment terms of Loan I and obligating themselves to pay back the $130,000 total within 181 days from the date signed.
>
> "Sanders and Kreissl used the proceeds to fund the purchase of stock in their name, in Tamarac, a publicly traded company. Thereafter, Sanders and Kreissl along with other shareholders of Debtor, exchanged their shares of Debtor for shares of Tamarac. Thus, Sander, Kreissl and the other shareholders became owners of the controlling interest in the share of Tamarac and Tamarac owned all shares of the Debtor. In 1986, Tamarac was renamed Sanders Confectionery Products, Inc. ("Sanders Confectionery").
>
> "Shortly after the formation of Sanders Confectionery, the company embarked on a public offering of about one-third of its stock in order to obtain the needed operating capital for the Debtor. However, the proceeds of that public offering were required to be held in escrow until

certain conditions were met. The Debtor needed capital in the meantime.

"In an effort to secure interim capital, Defendant Beim arranged for various investors, including Defendant Wertheimer to loan a total of $300,000 ("Loan II") to Sanders Confectionery, the corporate parent of Debtor. This loan was made on or about January 22, 1987, and the money obtained by Sanders Confectionery was given to and used by the Debtor.

"About one month after obtaining Loan II, $4.3 million in net proceeds from the public offering were released to Sanders Confectionery which immediately transferred the funds to the Debtor as a capital contribution. The money was used by Debtor to pay various overdue tax obligations as well as the following transfers at issue in this litigation:

> "(1) On January 21, 1987, Debtor paid a roll-over fee of $7,500 to Defendant Beim for $130,000 in personal loans to Defendants Sanders and Kreissl (Loan I).
>
> "(2) On April 16, 1987, Debtor paid the entire $130,000 principal of the personal loan of Defendants Sanders and Kreissl (Loan I).
>
> "(3) On January 27, 1987, Debtor paid Defendant Beim $18,000 in finder's fees in exchange for the $300,000 loan (Loan II) to Sanders Confectionery.
>
> "(4) Thereafter, Debtor paid $56,000 in interest and extension fees on Loan II to Defendants Beim, Wertheimer, and Yesod.

> "Debtor filed bankruptcy on November 16, 1987. On November 30, 1989, Trustee Jay Alix instituted proceedings to recover the transfers made with respect to Loans I and II on the theory that the transfers were fraudulent conveyances, or in the alternative, voidable preferences."

(Appendix to Petition, pp. 2a to 4a) (footnotes omitted).

REASONS TO DENY THE WRIT

I. Petitioners do not challenge the legal bases of the decisions of the lower courts.

A review of the petition shows that, although Petitioners disagree with the Bankruptcy Court's factual determination that the Debtor was insolvent on the dates of the transactions at issue in this matter, Petitioners do not claim that the courts below made any error of controlling federal law.

The petitioners have mischaracterized the rulings on that issue by the courts below. The Bankruptcy Court, after receiving testimony and documentary evidence, determined that the Trustee's evidence was more credible than Petitioners' evidence and that the Trustee had proved that the Debtor was insolvent on the dates of the transfers (Appendix to Petition, pp. 56a-57a). On appeal, the District Court (*Id.*, p. 28a) and the Court of Appeals (*Id.*, pp. 6a-7a) both affirmed the Bankruptcy Court's ruling on solvency as a determination of fact that was not clearly erroneous.

Petitioners litigated and lost the issue of insolvency in the Bankruptcy Court. Petitioners raised that issue on appeal to the District Court and then to the Court of Appeals. Petitioners were unsuccessful in both courts. There is no reason why the Supreme Court should afford petitioners a fourth opportunity to debate whether Debtor was insolvent on the relevant dates.

Therefore, the Court should deny the petition for writ of certiorari in this case.

II. The petition for certiorari contains many untrue assertions.

The petition for writ of certiorari includes many statements that are patently false. For example:

1. Petitioners Kreissl and Sanders did not merely guarantee the loans in question. Those loans were made to Messrs. Kreissl and Sanders as *primary* obligors, although the lenders were repaid with assets of the Debtor (*Id.*, pp. 13a-14a).

2. The Bankruptcy Court did not "base its determination of insolvency at the time of the transfers . . . upon the financial condition of the Debtor in May 1988. . . ." To the contrary, as the Bankruptcy Court noted in its decision, the Trustee presented convincing evidence that the Debtor was insolvent on the date of each transfer (*Id.*, pp. 47a-49a).

III. Relief Requested.

Respondent respectfully prays that this Honorable Court: (a) affirm the decisions below granting respondent judgment against petitioners; and (b) deny the Petition for Writ of Certiorari.

Respectfully submitted,

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